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C O N F I D E N T I A L BRASILIA 002051

SIPDIS

TREASURY FOR OASIA - NLEE AND SSEGAL
STATE FOR EB/IFD/OMA - KMOSS

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TAGS: EFIN ECON PREL BR
SUBJECT: IMF RESREP ON INVESTMENT ACCOUNTING INITIATIVE

REF: BRASILIA 291

Classified By: Economic Counselor Roman Wasilewski, Reasons 1.4 (b) and (d).

¶1. (C) Summary: An IMF mission visited Brazil the last two weeks of July to discuss a pilot project effort at how the IMF accounts for investment. The pilot project grew out of an initiative by President Lula, advocated in letters to the G-7 heads of state, to increase the space for investment within the budgets of countries on IMF programs. IMF Resrep Max Alier (please protect) says the trickiest part of the issue is project selection. It appears the GoB hopes for some IMF political cover as it seeks to build consensus to change the expenditure/investment mix within its fiscal constraints. End Summary.

¶2. (C) The GoB initiative was launched by Lula in early 2004, at a time when the GoB was under considerable criticism for having frozen investment spending budgeted by the Congress, in order to meet the primary surplus target (reftel). This coincided with pressure from Argentina for the GoB to support its defiant stance towards the IMF. Argentina's Kirchner argued that the GoA could not both meet the needs of its populace, meet its IMF budget targets and pay off its creditors. Lula's response sought, in a set of letters to the G-7 heads of state, support for an initiative to IMF for a change in how investment was accounted for in terms of primary surplus targets.

¶3. (C) Alier told Emboff that the easiest way to conceive of how the GoB's accounting proposal works is by comparison to the primary surplus target adjustor that was built into Brazil's current IMF program, which expires at the end of the year. The GoB was allowed to invest in a series of sanitation projects, in the amount that it had over-performed its primary surplus target in the previous year. The primary surplus target was adjusted downward by this amount. Likewise, in the pilot project case, the primary surplus target would adjust to account for investment on one of these agreed projects. It is not clear to post that in this pilot project case, as was the case with the sanitation projects, that there would be any requirement to have over-performed the target in previous periods.

¶4. (C) A sometimes bemused Alier pointed out that the GoB's IMF progam expired at the end of the year and there was no expectation that the GoB would seek a new one. That meant that the GoB could do as it wants with its budget next year, he pointed out. Neither had the GoB invoked its right to use the adjustor in the current program. Quite the contrary, it was significantly over-performing the primary surplus target, with the de-cascading and rate increase of the PIS/COFINS tax that formed part of last year's tax reform increasing revenues by 1% of GDP.

¶5. (C) In a separate conversation, Finance Ministry International Secretary Luis Pereira told Emboff that the GoB ultimate goal is to use the

¶6. (C) Alier emphasized that the investment accounting exercise only makes sense if you can find public investment projects with a positive ra
could usefully help the GoB re-build its project-evaluation capacity, which has eroded. This would have the happy knock-on effect of helping the GoB capacity to evaluate projects proposed under the prospective Public-Private-Partnerships law, which is still pending in Congress.

¶7. (C) Comment: It appears that the Finance Ministry, and maybe the GoB more broadly, hope to use the Fund pilot project for political cover as it works to change the expenditure/investment mix within existing financial constraints. Maintaining some level of IMF involvement through this pilot project would also help the GoB reassure the markets that it will remain fiscally responsible even as it looks to increase investment spending.
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